UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF WASHINGTON

In Re: FEATURE REALTY LITIGATION	NO. CV-05-0333-WFN ORDER GRANTING FEATURE REALTY'S CROSS-MOTION FOR PARTIAL SUMMARY JUDGMENT RE: KNOWN RISK DOCTRINE

This Order Also Relates to: CV-05-0165-AAM; CV-05-0222-AAM

Before the Court are Defendant United States Fidelity & Guaranty Company's [USF&G] Motion for Partial Summary Judgment Re: No Coverage Under Known Risk Doctrine (Ct. Rec. 111) and Feature Realty's [Feature] Cross-Motion for Partial Summary Judgment Re: Known Risk Doctrine (Ct. Rec. 129).

I. FACTS

The Court will not reiterate the extensive factual and procedural background summarized in previous summary judgment decisions, familiarity with which is assumed. Additional facts, as necessary, will be related in the Court's analysis of the summary judgment arguments.

II. LEGAL STANDARD

The Federal Rules of Civil Procedure provide for summary adjudication when "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the

affidavits, if any, show that there is no genuine issue as to any material fact and that the party is entitled to a judgment as a matter of law." FED. R. CIV. P. 56 (c). In a motion for summary judgment, "[i]f the party moving for summary judgment meets its initial burden of identifying for the court those portions of the materials on file that it believes demonstrate the absence of any genuine issues of material fact," the burden of production then shifts so that "the nonmoving party must set forth, by affidavit or as otherwise provided in Rule 56, 'specific facts showing that there is a genuine issue for trial.'" *T.W. Elec. Service, Inc. v. Pacific Elec. Contractors Ass'n*, 809 F.2d 626, 630 (9th Cir. 1987) (*citing Celotex Corp. v. Catrett*, 477 U.S. 317, 106 S. Ct. 2548, 91 L. Ed. 2d 265 (1986)); *Kaiser Cement Corp. v. Fischbach & Moore, Inc.*, 793 F.2d 1100, 1103-04 (9th Cir.), *cert. denied*, 479 U.S. 949, 107 S. Ct. 435, 93 L. Ed. 2d 384 (1986).

On cross motions for summary judgment, the burdens faced by the opposing parties vary with the burden of proof they will face at trial. When the moving party will have the burden of proof at trial, "his showing must be sufficient for the court to hold that no reasonable trier of fact could find other than for the moving party." William W. Schwarzer, SUMMARY JUDGMENT UNDER THE FEDERAL RULES: DEFINING GENUINE ISSUES OF MATERIAL FACT, 99 F.R.D. 465, 487- 488 (1984). In contrast, a moving party who will not have the burden of proof at trial need only point to the insufficiency of the other side's evidence, thereby shifting to the nonmoving party the burden of raising genuine issues of fact by substantial evidence. *T.W. Electric*, 809 F.2d at 630 (*citing Celotex*, 477 U.S. at 323); *Kaiser Cement*, 793 F.2d at 1103-04. In judging evidence at the summary judgment stage, the Court does not make credibility determinations or weigh conflicting evidence, and draws all inferences in the light most favorable to the nonmoving party. *T.W. Electric*, 809 F.2d at 630-31 (*citing Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 106 S. Ct. 1348, 89 L. Ed. 2d 538 (1986)); *Ting v. United States*, 927 F.2d 1504, 1509 (9th Cir. 1991). The evidence the parties present must be admissible. FED. R. CIV. P. 56(e).

Conclusory, speculative testimony in affidavits and moving papers is insufficient to raise genuine issues of fact and defeat summary judgment. *Thornhill Pub. Co., Inc. v. GTE Corp.*, 594 F.2d 730, 738 (9th Cir. 1979).

III. DISCUSSION

The present case concerns the extent of USF&G's duty to indemnify Feature under a policy issued by USF&G to the City of Spokane (the City) for the $5.5 million dollar 2005 settlement reached in the underlying state court litigation brought by Feature against the City. The City is not a party to this coverage dispute as it assigned its rights under the USF&G policy to Feature as part of the underlying settlement. The duty to indemnify can only be triggered if coverage actually exists. USF&G argues here that Feature cannot succeed on its claim to recover any insurance proceeds because the "known risk" doctrine precludes coverage of the settled claims. As USF&G has raised this issue in the form of an affirmative defense to coverage, USF&G bears the burden of proving the doctrine's applicability. *See Outboard Marine Corp. v. Liberty Mut. Ins. Comp.*, 154 Ill.2d 90, 180 Ill. Dec. 691, 607 N.E.2d 1204, 1212 (1992).

The Court begins with some brief background on the known risk doctrine.[1] This doctrine is a common law defense that exists independent of the particular terms of insurance

[1]Besides the term "known risk," courts also use the terms "known loss" and "loss in progress," with some courts viewing these as distinct theories resting on the same principle and others viewing them as the same. As courts in Washington have equated these doctrines, it is unnecessary for the Court to explore the distinctions, if any, here. *See Hillhaven Properties Ltd. v. Sellen Const. Co., Inc.*, 133 Wash. 2d 751, 758-759, 948 P.2d 796 (1997). Although it seems most commentators agree "known loss" is most accurate in its description of the doctrine of fortuity, the Court will use the term "known risk" as it was utilized by the parties in their motions.

policies. 7 COUCH ON INSURANCE § 102:8; § 102:9 (3d ed. 2000). Sometimes the doctrine is described as being rooted in the policy of preventing fraud. Sometimes it is described as based on the essential characteristic of insurance -- the transfer from the policyholder to the insurer the risk of fortuitous losses, not losses that are reasonably certain or expected to occur within the policy period. *Alcoa v. Aetna Cas. & Sur. Co.*, 140 Wash. 2d 517, 998 P.2d 856, 878-79 (2000). In Washington, the known risk defense has been said to prevent "collect[ion] on an insurance claim for a loss that the insured subjectively knew would occur at the time the insurance was purchased."[2] *Pub. Util. Dist. No. 1 v. Int'l Ins. Co.*, 124 Wash. 2d 789, 881 P.2d 1020, 1030 (1994). There are almost as many formulations of the doctrine as there are jurisdictions that have adopted it, with variations in: (1) how "loss" is defined, (2) the degree of certainty of the insured's knowledge that the loss has or will occur, and (3) whether the insured's knowledge is judged by a subjective or objective standard. Though the parties have

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[2]The Court is aware that in some jurisdictions the spectrum of standards implemented for the so-called non-fortuity defenses are applied differently depending on whether the case involves first- or third-party insurance. *See e.g. Montrose Chemical Corp. v. Admiral Ins. Co.*, 10 Cal. 4th 645, 913 P.2d 878 (Cal. 1995) (holding that the loss-in-progress rule will not defeat coverage for a claimed loss where it had yet to be established, at the time the insurer entered into the contract of insurance with the policyholder, that the insured had a legal obligation to pay damages to a third party in connection with a loss). This is because, in the case of third party insurance, the contingent event insured against is not the loss itself, but rather the insured's legal obligation to pay for damages to others arising from the loss. The Washington Supreme Court, however, has not distinguished between the two types of policies and relies instead upon the general principle that one who knows of a loss or a liability, whether as a first or third party, should not be allowed to insure against either. *See Hillhaven Properties Ltd. v. Sellen Const. Co., Inc.*, 133 Wash. 2d 751, 762-763, 948 P.2d 796 (1997)

cited to some of these various formulations, the Court finds it unnecessary to resolve their differences in order to apply the doctrine coherently here.

As the Court is bound to apply the law as expressly enunciated in the state of Washington, the Court turns first to the seminal Washington case, *Pub. Util. Dist. No. 1 v. Int'l Ins. Co.*, 124 Wash. 2d 789, 881 P.2d 1020 (Wash. 1994). The case bears resemblance to this case in that it also involved a coverage dispute with a third party excess liability insurance carrier following a settlement. In the underlying dispute, bondholders had filed class actions for alleged securities law violations against ten public utility districts [PUDs] and other individual utility commissioners and employees in connection with the termination of several public power supply plants and the sale of the bonds financing the power projects. *Id.* The PUDs eventually settled and as part of the settlement received an assignment of excess liability insurance policies which the bondholders had previously received as part of their settlement with the individual defendants. *Id.* After the settlement, the PUDs then filed this case against the excess liability insurers seeking to recover under these policies. *Id.* At trial one insurer, Industrial, claimed coverage under its policy was precluded by the known risk doctrine. The trial court had given the following instruction to the jury:

> The 'known risk' principle only applies if you find that the insureds know that there was a substantial probability that they would be sued by the bondholders for securities violations at the time the Industrial policy was issued[.]

Id. at 806. On appeal, the insurer claimed the jury instruction too narrowly defined the known risk doctrine. *Id.* The insurer felt coverage should be excluded because the PUDs knew of the liability causing event (the termination of the power plants and the sale of the bonds) and they knew of the possibility of lawsuits and losses arising from that event when they purchased the insurance policy. *Id.* The Washington Supreme Court rejected the insurer's argument and affirmed the trial court's use of a subjective "substantial probability" test. *Id.* at 808. In other words, it was not error to require the insurer to prove the policyholder's actual knowledge of a substantial probability of loss in order to bar coverage. Strong

indicators of the substantial likelihood of loss would not have been enough under this standard. Also significant here, is how the loss was defined. Even though the PUDs arguably knew at time they purchased the insurance that they might be subject to suits and losses arising from termination of power plants, knowledge of the likelihood of losses in general was insufficient. *Pub. Util. Dist. No. 1* held that in order for the known risk doctrine to apply, the insured must possess knowledge of the likelihood of the same type of loss, or in this instance, the type of suit, that actually occurred. *Id.*

USF&G advocates for a broader formulation of the known risk doctrine than utilized in *Pub. Util. Dist. No. 1*. However, no matter how the doctrine is formulated in its fine points, both parties and every court decision uniformly emphasize the importance of some sort of "knowledge" actually possessed by an insured. In addition, more is required than mere awareness of a potential risk of a loss or of the potential that damages may arise sometime in the future traceable to some act known to have occurred in the past. The doctrine is triggered by an awareness of the certainty of a loss or at least the "substantial probability" of a loss. Finally, the loss is defined by the specific type of claim which eventually actually occurred. The Court would add that a policyholder's awareness of the substantial probability of loss has been shown through evidence which demonstrates when the policy holder first received notice of the events forming the basis for the underlying suit. Indeed, it is the fact that the liability-causing event is known to the insured, that supports the use of the doctrine. *Hillhaven Props.*, 133 Wash. 2d 751, 758, 948 P.2d 796 (1997) (*citing Pub. Util. Dist. No. 1*, 124 Wash. 2d at 806, 881 P.2d 1020). Understood against this backdrop, the evidence of record does not give rise to a known risk to defeat coverage here.

In order to sustain its burden USF&G must demonstrate the City of Spokane subjectively knew at the policy's inception (September 1999) that there was a substantial probability it would be sued by Feature for its behavior contributing to the alleged delay in the processing of the amended plat application. The Court's inquiry must therefore focus on

what and how much information the City had about (1) the events which eventually formed the basis of Feature's tortious interference claim against the City and (2) the risk of loss/liability that behavior posed. In this case, the events generally alleged to have been the cause of Feature's losses were the City's alleged acts and omissions resulting in the alleged delay in the processing of the plat amendment.

Despite electing to pursue this argument on summary judgment rather than at trial, USF&G has produced no evidence touching on the policyholder's knowledge or awareness at this critical time period. Instead, USF&G simply maintains: "[T]his court's December 13, 2006 order establishes that the process causing the loss began on May 19, 1999. The USF&G policy commenced on September 1, 1999. Accordingly, the Known Risk doctrine precludes coverage to the City." Ct. Rec. 148 [USF&G's Reply Memo.] at 14. To be clear, the Court's December 13, 2006 order established that the factual basis forming the basis of the tortious interference claim resolved by the 2005 settlement agreement was alleged acts or omissions taken by the City from and after May 1999. The fact that the events or occurrences forming the basis of Feature's tortious interference claim originated prior to the inception of the USF&G insurance policy, does not by itself preclude coverage. Indeed, neither party maintains and the Court is not aware of any rule which prohibits an insured from purchasing coverage against future, unknown claims, even though the loss from which claims may arise has already occurred or may be in the process of occurring.

USF&G's assertion that the City had "received strong indications" (Ct. Rec. 112 [USF&G's Memo.] at 15) that a loss would occur is fundamentally disconnected from any facts in evidence pertaining to the time period prior to the inception of the insurance policy. In 1998, the City had entered into a stipulated settlement agreement with Feature which resolved the parties' claims then pending before the superior court and set forth a framework for resolving future issues related to the Canyon Bluffs development, including obligations regarding the submission and processing of plan modifications and the issuance of permits.

Ct. Rec. 1, Ex. A [Stipulated Settlement Agreement] in 03-CV-0063-JLQ. During settlement talks, Feature had apparently discussed with the City its desire to revise the previously approved plat to convert several previously planned multi-family lots into single family lots. Although the City had knowledge of these facts, these facts provide no evidence of a substantial probability of liability for interference relating to the alleged delay.

It is also undisputed that on May 19, 1999, Feature submitted an amended plat application with the City and the City did not approve the application prior to the inception of the policy.[3] Critically absent from the record, however, is any evidence of the City's knowledge of these events. Indeed, the declaration of Assistant City Attorney Milton Rowland provides that the first time he heard of the plat amendment application filed by Feature was in *June 2000* when he received an inquiry from Feature's attorney, Blaine Morley, regarding the status of the application. Ct. Rec. 128 [Rowland Decl.] at ¶ 4. After investigating the matter with City personnel, Mr. Rowland advised Mr. Morley that the City could not locate the plat amendment documents and that he could not find any City personnel who had knowledge of them. *Id.* The declaration of Blaine Morley is consistent with this assertion. Ct. Rec. 127 [Morley Decl.] at ¶ 5. Finally, it is undisputed that Feature did not assert any claim based upon the delay in the processing of the plat amendment until years after the inception of the policy. Ct. Rec. 133 [Feature's S.O.F.] at ¶ 10. Nor had the City's attorney heard of any threatened claim by Feature prior to September 1999. *Id.* at ¶ 9.

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[3] USF&G contends that the City's "failure and/or refusal to approve the May 19, 1999 amended plat application" establishes that the City had knowledge that a loss would occur. Ct. Rec. 112 [USF&G's Memo.] at 20. A "refusal" is an act, rather than a failure to act or an omission. There is no evidence in the record of the City "refusing" to approve the application prior to September 1999, or for that matter, taking any action upon it prior to June 2000.

The uncontradicted evidence of record suggests City officials were not even aware of Feature's May 1999 filing of the amended plat application and their own inaction in processing it until sometime in the year 2000, well after the inception of the policy period.[4] Logically, the City could not have had any awareness of the possible effects of its conduct until after becoming aware of the circumstance itself. While USF&G urges the Court not to "blindly accept[] whatever the insured claims to have known or not known prior to the inception of the policy," (Ct. Rec. 148 [USF&G Reply Memo.] at 10) it is the litigants' burden on summary judgment to present the relevant facts and USF&G has presented no evidence to cause the Court to question the present record.

USF&G may speculate that had the City taken different steps upon the filing of the amended plat application, the City may have become aware of an increased likelihood of the risk of loss associated with its conduct prior to the inception of the USF&G policy. But summary judgment is not about hypothetical facts not in the record. Moreover, the known

[4]USF&G contends Feature should be judicially estopped from contending the City was ignorant of the delays prior to September 1999, arguing the position contradicts Feature's prior assertions that Feature's claims against the City were based upon wrongful conduct commencing in May 1999. Ct. Rec. 148 [USF&G's Reply Memo.] at 12. Feature's positions are not inconsistent or opposite. Feature's position in the underlying litigation that the City should be held liable for its acts and omissions from and after May 19, 1999, says nothing as to the nature and extent of City's knowledge of those acts or omissions, or the City's knowledge of the risk of loss those actions posed from May 1999 to September 1999. The relevant considerations, including the knowledge element, for tort liability and the known risk defense are not one and the same.

risk doctrine was not intended as a tool for punishing the insured for what it did not know, but perhaps might have known under different circumstances.[5]

IV. CONCLUSION

As there is no evidence from which a fact finder could possibly conclude the City of Spokane possessed the requisite knowledge of a substantial probability of loss prior to the

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[5]Where the policyholder lacked actual knowledge, some jurisdictions have applied the known risk doctrine less stringently and found it sufficient that the policyholder have only "a reason to know," or "evidence of a probable loss." *See Missouri Pac. R.R. v. American Home Assur. Co.* (1997), 286 Ill. App.3d 305, 221 Ill. Dec. 648, 675 N.E.2d 1378 (1997); *Outboard Marine, supra*, 154 Ill.2d 90, 180 Ill. Dec. 691, 607 N.E.2d 1204; *Carter Lake v. Aetna Cas. and Sur. Co.*, 604 F.2d 1052 (8th Cir. 1979). This standard has been used primarily in the environmental context, for example, where a business regularly disposed of chemicals that it knew or should have known involved a probability of contamination. *See American States Ins. Co. v. Maryland Cas. Co.*, 587 F. Supp. 1549 (E.D. Mich. 1984). Though Washington has not utilized such an approach, USF&G argues for its application here. Regardless of which standard of knowledge is used, the Court is aware of no case where insurance coverage was denied where the insured was actually ignorant of the events or conduct contributing to the increased risk of loss. Indeed, precluding coverage based upon the insured's negligent failure to investigate and obtain knowledge of its own omission would defeat the very purpose of third party liability coverage. *See Chu v. Canadian Indem. Co.*, 224 Cal. App.3d 86, 94-95, 274 Cal. Rptr. 20 (4th Dist. 1990). "The insured may be negligent indeed in failing to take precautions or to foresee the possibility of harm, yet insurance coverage protects the insured from his own lack of due care." *Armstrong World Industries, Inc. v. Aetna Casualty & Surety Co.*, 45 Cal. App. 4th 1, 52 Cal. Rptr. 2d 690 (1996).

inception of the USF&G insurance policy, the Court concludes that the "known risk" defense[6] does not bar potential coverage under the policy issued by USF&G. Accordingly,

IT IS ORDERED that:

1. United States Fidelity & Guaranty Company's Motion for Summary Judgment Re: No Coverage Under Known Risk Doctrine, filed January 25, 2007, **Ct. Rec. 111**, is **DENIED**.

2. Feature Realty's Cross-Motion for Partial Summary Judgment Re: Known Risk, filed February 5, 2007, **Ct. Rec. 129**, is **GRANTED**.

The District Court Executive is directed to file this Order and provide copies to counsel.

DATED this 10th day of May, 2007.

s/ Wm. Fremming Nielsen
WM. FREMMING NIELSEN
SENIOR UNITED STATES DISTRICT JUDGE

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[6] The Court's ruling also applies to the "known loss" and "loss in progress" defenses.